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No. 91-1777

In The

Supreme Court of the United States

October Term, 1991

AMWEST SURETY INSURANCE COMPANY,

Petitioner,

versus

UNITED FIDELITY & TRUST CO.,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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STATEMENT OF ISSUES PRESENTED

1. Whether the Assignment of Claims Act, 31 U.S.C. § 3727 and 41 U.S.C. § 15, grants the assignee thereunder a superior right to assigned contract payments (exclusive of retainage) owed by the United States vis-a-vis a Miller Act Surety, 40 U.S.C. § 270a, who issued payment and performance bonds to secure the performance of the contract.

2. Whether a Miller Act Surety has stated a case for equitable subrogation vis-a-vis an assignee of contract payments owed by the United States where the monies lent by the assignee to the contractor were used by the contractor for performance of the contract and therefore relieved the Miller Act Surety of obligations it otherwise would have incurred under its payment and performance bonds.

3. Whether a Miller Act Surety is estopped from asserting a priority vis-a-vis an assignee of contract payments owed by the United States where the Miller Act Surety has acquiesced in the assignment of the contract payments by the contractor to the assignee and benefitted from the continued lending by the assignee in reliance upon the assignment.

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STATEMENT OF THE CASE

A. Introduction.

This action involves the ranking of the claims of United Fidelity & Trust Company ("Fidelity") and Amwest Surety Insurance Company ("Amwest") against a fund consisting of contract payments withheld by the United States on a dredging contract (the "Columbus Lake Contract") between the Army Corps of Engineers (the "Corps") and River Products, Inc. ("River Products"), a debtor in bankruptcy. There is not any dispute as to the retainage portion of the funds owed on the Columbus Lake Contract. Fidelity is the assignee, pursuant to the Assignment of Claims Act, 31 U.S.C. § 3727, and 41 U.S.C. § 15, of the contract payments owed River Products under the Columbus Lake Contract. In connection with River Product's assignment of the contract payments to Fidelity (the "Assignment"), Fidelity provided interim financing to River Products to perform the Columbus Lake Contract. Amwest is a surety who, pursuant to the Miller Act, 40 U.S.C. § 270a, issued payment and performance bonds in favor of the United States to secure the performance by River Products of the Columbus Lake Contract.

B. Statement of Facts.

River Products and the Corps entered into the Columbus Lake Contract on April 3, 1989. As a requisite for the Columbus Lake Contract, on March 30, 1989, Amwest issued payment and performance bonds with Amwest as surety and River Products as principal and the Mobile

District Corps of Engineers as obligee. Prior to the issuance of the payment and performance bonds, River Products and Amwest entered into a General Indemnity Agreement (the "Indemnity Agreement"), wherein River Products assigned to Amwest all its right, title and interest to the Columbus Lake Contract payments. However, this Indemnity Agreement was not recorded to notify third parties of Amwest's interest in the Columbus Lake Contract in accordance with Louisiana law.

River Products commenced performance on the Columbus Lake Contract on or about April 3, 1989. On April 17, 1989, River Products executed an assignment of the payments due or to become due on the Columbus Lake Contract in favor of Fidelity as security for the sums to be loaned by Fidelity in connection with River Products' performance of the Columbus Lake Contract. Fidelity mailed the Notice of Assignment to the Disbursing Officer for the Columbus Lake Contract and the Contracting Office for the Corps, and in due course the Notices were acknowledged. In consideration of the Assignment, Fidelity provided interim financing to River Products for use by River Products towards fulfillment of its obligations under the Columbus Lake Contract.[1]

Fidelity, Amwest and River Products reached an impasse as of July 25, 1989, regarding the continued financing of the Columbus Lake Contract.[2] The uncontroverted evidence presented by Fidelity demonstrated

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[1] Record Excerpt of Appellee, United Fidelity & Trust Company (hereinafter referred to as Appellee R.E.) No. 4.

[2] Appellee R.E. No. 7; Appellee R.E. No. 8.

that Fidelity continued to extend credit to River Products only after Amwest had assured Fidelity that Amwest would not be required to perform on its bond if Fidelity provided additional financing to River Products.[3] Based on Amwest's assurances, Fidelity lent substantial additional monies to River Products that remain unpaid and are part of the claim which Fidelity now asserts. River Products continued its work on the Columbus Lake Contract and completed the work on September 14, 1989 utilizing funds from Fidelity.[4] All loan proceeds from Fidelity were in fact used by River Products in connection with the Columbus Lake Contract.[5]

Amwest ultimately paid under its payment bond certain suppliers and laborers for work that River Products had contracted for in the course of its performance on the Columbus Lake Contract but had failed to pay. River Products was unable to pay either Fidelity or Amwest the sums due them. On September 26, 1989, River Products filed a voluntary petition under Chapter 11 of the Bankruptcy Code. In connection with the bankruptcy case, Fidelity filed an adversary proceeding against River Products, Amwest and the United States of America seeking to have the Bankruptcy Court determine the priority of its security interest in the payments due by the Corps under the Columbus Lake Contract. In connection with the adversary proceeding, the Corps deposited $318,409.30 into the Registry of Court as the total sum due and owing under the Columbus Lake Contract. Of

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[3] Id.

[4] Appellee R.E. 5.

[5] Id.

this amount, $12,075.00 represented the retained portion or retainage withheld pursuant to the Columbus Lake Contract by the United States as security for the complete performance of the Columbus Lake Contract by River Products.[6]

C. The Rulings of the Courts Below.

The case was decided on opposing motions for summary judgment; there were not any contested issues of fact. Fidelity contended that as a matter of law it had a superior right to the contract payments under the Assignment of Claims Act since it had received its assignment prior to River Product's default under the Columbus Lake Contract. Fidelity further contended that its claim outranked Amwest's equitable subrogation claim since Amwest did not undertake to complete the project and the monies lent by Fidelity had been used by River Products in the performance of the Columbus Lake Contract. Finally, Fidelity urged that Amwest was estopped to challenge Fidelity's superior claim because Amwest had consented to the assignment and encouraged additional

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[6] Appellee R.E. No. 5; Appellee R.E. No. 6. Under a typical government construction contract, the contract provides that the government will "retain" a certain percentage of the contract price until final completion of the contract by the contractor. As the contractor completes portions of the project, the government makes periodic progress payments to the contractor, or his assignee, but the government is entitled to retain a percentage of the contract price, specified in the contract, to insure the contractor's complete performance of the contract and to protect the government from any damages arising out of the contractor's non-performance. This portion is commonly referred to as the "retainage".

lending by Fidelity with assurances that it would not perform on its bond if additional financing were made available by Fidelity. Contrariwise, Amwest asserted that its claim, based on its equitable right of subrogation, was superior to Fidelity's legal rights under the assignment because the surety bond was issued prior to the assignment.

The Bankruptcy Court noted that Amwest's payment and performance bonds were issued on March 30, 1989, prior to the Assignment made to Fidelity on April 17, 1989. Based on this fact alone, the Bankruptcy Court held that Amwest had a superior right to the funds. The District Court reversed, acknowledging the controlling authority of *Coconut Grove Exchange Bank v. New Amsterdam Casualty Co.*, 149 F.2d 73 (5th Cir. 1945), and *General Casualty Co. v. Second National Bank of Houston*, 178 F.2d 679 (5th Cir. 1949). *Coconut Grove* and *General Casualty* provide that under the Assignment of Claims Act an assignee's legal right to contract payments owing on a Government contract, except for the retained portion withheld under the contract as security for complete performance (the "retainage"), is superior to the surety's equitable right to those payments where the funds loaned to the contractor by the assignee are used in the performance of the contract and the surety did not undertake to complete the contract. Accordingly, the District Court entered judgment in favor of Fidelity recognizing its priority over Amwest to the contract proceeds held in the Registry of the Court, except as to the retainage sum of $12,075.00 owed on the contract, all subject to the disposition of the claim of the Internal Revenue Service for unpaid taxes owed by River Products. Because of its

reliance on *Coconut Grove* and *General Casualty*, the District Court did not address Fidelity's contention that Amwest was estopped to deny the priority of Fidelity's claim. The Fifth Circuit affirmed the District Court in a *per curiam, unpublished* opinion, holding that the District Court had correctly applied *Coconut Grove* and *General Casualty* to the facts. This opinion did not address the estoppel arguments of Fidelity.

REASONS FOR DENYING THE WRIT

Amwest requests this Court to grant a writ of certiorari based on a purported inconsistency between the Fifth Circuit's decisions in *General Casualty* and *Coconut Grove* and this Court's opinions in *Prairie State Bank of Chicago v. United States*, 164 U.S. 227, 17 S. Ct. 142, 41 L. Ed. 412 (1896), and *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S. Ct. 233, 9 L. Ed. 190 (1962). Amwest also asserts that this Court should grant certiorari based on the purported disagreement among the circuits as to the competing rights of an assignee and a surety to progress payments owed by the government to a contractor which is in default of its obligation to pay suppliers. This Court should deny the petition for writ of certiorari because *Coconut Grove* and *General Casualty* are consistent with Supreme Court authorities and there is no conflict among the courts of appeal.

1. The Fifth Circuit Jurisprudence Is Consistent with Supreme Court Authorities.

In *Coconut Grove*, a Miller Act surety sued an assignee under the Act for recovery of payments made to it by the United States on a bonded government contract. In holding that the assignee should receive the payments from the government in preference over the surety, the Fifth Circuit noted that the Assignment of Claims Act of 1940 was intended to encourage private financing of government contracts "and to make it so contractors could borrow money from banks and other lending institutions so as to thereby promote the national defense . . . " *Coconut Grove*, 149 F.2d at 77.[7] The Fifth Circuit then noted that, consistent with the Assignment of Claims Act, the rights of the surety are subordinate to those of the assignee:

> The [Assignment of Claims Act] expressly made it lawful for the Contractor to assign the proceeds of his contract to a bank, whereupon all the proceeds shall be paid to that bank, and since it permitted that to be done but did not permit an assignment to a surety company, the [Assignment of Claims Act] did definitely and incidentally affect the rights of the bank and of the surety.

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[7] The Assignment of Claims Act of 1940 was an amendment to the federal anti-assignment statutes which made an assignment of government contract payments null and void. The original heading of the amendment was as follows: "To assist in the national defense program by amending sections 3477 and 3737 of the Revised Statutes to permit the assignment of claims under public contract." 54 Stat. 1029.

Id. at 78-79. Accordingly, the Fifth Circuit held that under the Assignment of Claims Act the assignee's claim to the contract payments outranked the surety's claim.

In *Coconut Grove* the Fifth Circuit also concluded that, "irrespective of the effect of said Section 203, as amended, [the Assignment of Claims Act]" the surety was required, in order to state and make out a case for equitable subrogation vis-a-vis the assignee, "to allege and to prove that the funds advanced by the Bank to the Contractor were diverted from purposes essential to the performance of the contract." In recognizing the assignee's superior interest, the Fifth Circuit emphasized that *equity* dictated that the assignee/lender, rather than the surety, be given superior rights to progress payments owed under a government contract since the lender's monies had been applied to satisfy obligations arising under the contract which the surety would otherwise have incurred had the surety taken over performance of the contract.

> But no superior equity in the Surety will appear unless it shows that the money lent by the Bank was diverted or used for purposes outside the contract, for if the money lent was applied to the payment of labor and materials used in the contract, thereby discharging obligations for which the Surety would otherwise have been liable, the Surety was in no wise injured by the transaction.

Id. at 78.

In *General Casualty Co.*, the Fifth Circuit revisited the issue raised in *Coconut Grove* and reaffirmed its position.

The court of appeals rearticulated the reasons it had set forth in *Coconut Grove* for concluding that the Assignment of Claims Act contemplated that an assignment made thereunder prior to the contractor's default would be free and clear of any liens. 178 F.2d at 680. However, the Fifth Circuit recognized that the surety had superior rights vis-a-vis the assignee to the retained portion withheld by the government under the contract as security for completion of the contract.

> But the ten per cent retained each month under the contract was held by the owner for the protection of itself and the surety. In these retained percentages, the contractor could give no one a right superior to that of the owner and the surety.

178 F.2d at 680. Thus, Fidelity in the instant case did not assert a superior claim to the retainage portion of the funds.

The reasons cited by the Fifth Circuit in *Coconut Grove* and *General Casualty* for ranking an assignee's legal claim to progress payments ahead of the equitable claim of a surety are fundamentally sound and consistent with this Court's rulings both before and after *Coconut Grove* and *General Casualty*. In making its ruling in *General Casualty*, the Fifth Circuit cited to and fully adopted the principles established by this Court in *Prairie State Bank, supra*. 178 F.2d 680. In *Prairie State Bank* this Court addressed the respective equitable rights of a purported assignee and a surety to the *retained portion* held by the United States on a government construction contract as security for complete performance by the contractor. As in *Prairie State Bank*, the Fifth Circuit held in *General*

Casualty that the surety's claim to the retained percentage was inviolate and could not be assigned to the prejudice of the surety.[8] Additionally, this Court's opinion in *Prairie State Bank* was decided several years before the amendment to the Assignment of Claims Act, which specifically authorized the assignment of claims against the government in favor of a financing institution. Accordingly, *Prairie State Bank* does not address the issues in this case.

Coconut Grove, General Casualty and the instant case are also consistent with *Pearlman v. Reliance Ins. Co., supra,* which was decided after *General Casualty*. In *Pearlman,* the Supreme Court held that a bankruptcy trustee, as a hypothetical judgment lien creditor, did not acquire superior rights vis-a-vis a Miller Act surety to the *retained portion* withheld by the government under a contract as security for complete performance by the Contractor. Since *General Casualty, Coconut Grove* and the instant case only involve the competing rights of an assignee prior to default and a surety, *Pearlman* is not implicated. *Pearlman* did not address the status of an assignee under the Assignment of Claims Act. Additionally, since *General Casualty* holds that a surety's rights to the *retained portion* are inviolate, even vis-a-vis an assignee prior to default, *General Casualty* is clearly not in conflict with any principle set forth in *Pearlman* and indeed presaged *Pearlman*.

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[8] Consistent with *Prairie State Bank,* the District Court and the Fifth Circuit in the instant case recognized Amwest's superior claim to the retainage.

2. The Fifth Circuit's Ruling Does Not Place It In Conflict With Other Courts of Appeal

Rule 10 of the Rules of the Supreme Court provides that this Court will consider review of a case on a writ of certiorari when, *inter alia,* a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeal. Amwest contends that a decisive conflict exists among three circuits as to the legal ranking of competing claims asserted against the government by an assignee under the Assignment of Claims Act and a Miller Act Surety for progress payments owed by the government to a contractor for work performed under a completed government contract.

Amwest asserts that *Coconut Grove* and *General Casualty* are in conflict with the opinion of the Court of Appeals for the D.C. Circuit in *Industrial Bank of Washington v. United States,* 424 F.2d 932 (D.C. Cir. 1970). However, in *Industrial Bank* the facts and equities were significantly different from those at issue in *Coconut Grove* and *General Casualty.* The Fifth Circuit cases are based on circumstances where the contractor has completed a government contract using funds lent by the assignee. In *Industrial Bank* the assignee asserted its claim vis-a-vis the surety through a contractor who was terminated prior to completing the job. The contractor in fact owed the government money for extra payments made by the government, for which the surety was liable, to procure another contractor to finish the project. Unlike the assignee/lender in *General Casualty,* the assignee/lender in *Industrial Bank* had not lent funds which had been used by the

contractor to complete the contract and avoided payments by the surety which it would have otherwise made under its bond had the surety completed the contract. In addressing the assignee's claim to priority under the Assignment of Claims Act, the D.C. Circuit concluded that:

> The words of the act are not properly applied if, *following a termination for default,* they are construed to give the bank as assignee of the contractor a right to funds in the hands of the Government which are needed for completion of the contract.

424 F.2d at 934 (emphasis added). Accordingly, *Industrial Bank* is not in conflict with *Coconut Grove* and *General Casualty*.

Amwest additionally contends that *Coconut Grove* and *General Casualty* are in conflict with *Balboa v. United States*, 775 F.2d 1158 (Fed. Cir. 1985), a case in which the Assignment of Claims Act was not even discussed, much less at issue. In *Balboa* a Miller Act surety had issued payment and performance bonds in favor of the government on a construction contract. During the contractor's performance of the contract, the surety notified the government that the contractor was in default of its obligations under the contract and surety bonds on account of the contractor's failure to pay its subcontractors and suppliers, and the surety requested that the government withhold the progress payments owed to the contractor for completed work. However, the government paid the contractor notwithstanding the surety's request. The surety sued the government for wrongfully paying the contractor in light of its notice of the contractor's default

and the surety's request that the government withhold payment. The Federal Circuit concluded that in such a situation the government is a stakeholder in a dispute between the surety and the contractor and that, as a stakeholder, the government has a "duty to act with reasoned discretion when a Miller Act Surety alleges that the contractor has breached the contract by defaulting under its bonds."

Although *Balboa* did not address any issue arising under the Assignment of Claims Act or its relationship to the Miller Act, Amwest urges that *Balboa* is inconsistent with *Coconut Grove* and *General Casualty* by implication. Amwest points out that *Balboa* is premised on the Federal Circuit's determination that a surety's interest in a contract payment owed on a bonded government contract is superior to the contractor's interest once the contractor has defaulted on its obligations under the contract and surety bonds. Based on this premise, Amwest argues that it necessarily follows that an assignee's rights, being derivative of the contractor's rights, are inferior to a surety's rights to the contract payments and that *Balboa* is therefore inconsistent with *Coconut Grove* and *General Casualty*.

Amwest's contention that *Balboa* is in conflict with *Coconut Grove* and *General Casualty* is erroneous. In *Balboa*, the Federal Circuit did not address the central issue in *Coconut Grove*, *General Casualty*, and the instant case: whether the surety's equitable right of subrogation is superior to the legal rights of an assignee under the Assignment of Claims Act when the assignee has loaned the contractor the very funds which the contractor has used to pay for the labor and supplies required by the

contract, all to the benefit of the surety. Moreover, like *Balboa*, both *Coconut Grove* and *General Casualty* recognize that the surety has an equitable right of subrogation to the contract payments which outranks the claim of the contractor. However, in *Coconut Grove* and *General Casualty*. the Fifth Circuit recognized that a Miller Act surety's claim to contract payments owed to a contractor in default of the contract, while superior to that of the contractor, is inferior to the assignee's claim.

Amwest finally asserts that the decision of the United States Claims Court in *Reliance Ins. Co. v. United States*, 15 Cl. Ct. 62 (1988), is contrary to the principles established in *General Casualty* and *Coconut Grove*. Although the Claims Court ruled in favor of the surety in *Reliance*, as opposed to the assignee, the Claims Court specifically noted that there was no evidence before it that the assignee had loaned the contractor any monies for use in the contract. 15 Cl. Ct. at 65. In this regard, *Reliance* is clearly distinguishable from *Coconut Grove* and *General Casualty*. Moreover, in *Reliance* the surety, not the assignee, financed the completion of the contract. 15 Cl. Ct. at 63. The facts of *Coconut Grove* and *General Casualty* are exactly the converse.[9]

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[9] If *Reliance* were inconsistent with *Coconut Grove* and *General Casualty*, a conflict between the Claims Court and the Fifth Circuit Court of Appeals would not constitute a conflict between the courts of appeal. The Claims Court is merely a trial court. 28 U.S.C. § 157. The decisions of the Claims Court are appealable to the United States Court of Appeal for Federal Circuit. 28 U.S.C. § 1295(a)(3). Moreover, the Claims Court is an Article I court and lacks the full authority of an Article III

(Continued on following page)

CONCLUSION

Since the jurisprudence of the Fifth Circuit Court of Appeals relating to the competing rights of an assignee and surety to progress payments withheld on a completed government contract is consistent with all decisions of this Court and is not in conflict with any decision of another court of appeals, this Court should deny the petition for writ of certiorari.

Respectfully submitted,

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court. *Id.* Accordingly, a decision of the Claims Court will not, absent other compelling reasons, justify the grant of a writ of certiorari to review a decision of the Fifth Circuit.